Luxembourg Country Report 2007

1. Economic and Financial Background

Table 1: Key economic and financial indicators		
	2005	**2006**
Population (million)	0.455 [(1)]	0.459 [(2)]
GDP (EUR billions)	29.32 [(3)]	33.05 [(3)]
Real GDP growth (%)	4.0	6.2
Inflation rate (%)	2.5 [(4)]	2.7 [(4)]
Unemployment rate (%)	4.5[(4)]	4.8[(4)]
Stock market capitalisation (EUR billions)	43.448	60.303
Stock market capitalisation (% of GDP)	160.59	235.79

[(1)] As of 01/01/2005 / [(2)] as of 01/01/2006
[(3)] Market price
[(4)] Average annual rate

2. Data on funds under management and portfolios

Number of	**June 2006**	**Dec 2006**	**June 2007**
Home-domiciled funds	2 130	2 238	2 352
of which			
➢ **Stand-alone funds**	794	851	893
➢ **Multiple compartment funds**	1 336	1 387	1 459
Home-domiciled units	8 909	9 473	10 042
of which			
➢ **UCITS**	7 525	7 919	8 307
➢ **Non-UCITS**	1 384	1 554	1 735
Foreign funds registered for sales	189	191	n.a.
Fund Launches / registrations	136 [(1)]	345 [(1)]	229 [(1)]
Fund Liquidations	66	167	115
Unit Mergers	n.a.	223	n.a.

(1) since the 1st January

NB: UCITS is used in the sense of publicly offered open-end funds investing in transferable securities and money market funds.

Data shown to two decimal places

End of period	Total number of fund units	Of which: Fixed income	Equity	Balanced	Money Market	Others
June 2006	8 909	2 469	3 027	1 219	574	1 620
Dec 2006	9 473	2 607	3 152	1 421	512	1 781
June 2007	10 042	2 688	3 259	1 647	524	1 924

At the end of 2006, the number of legal entities domiciled in Luxembourg was 2,238. During the course of the year 345 new funds were launched, that is nearly 30% more than in 2005. At the same time 167 funds were withdrawn from the market. The net variation over the year amounted to +178 new funds, representing a net growth rate of 8.6%.

The number of net new fund creations in 2006 increased by 93% over the previous year, which was itself a bumper year. Just as 2006 was outstanding in terms of assets under management, it was equally the best year since 1995 in terms of the creation of new funds.

With regard to the number of fund units domiciled in Luxembourg (that is, the number of single funds plus the sub-funds of umbrella structures), the growth is even more marked with a net increase of 976 units bringing the total to 9,473 at the end of the year.

Whereas the number of fund units launched in 2006 (9 473 units) grew by 11.5% more than in 2005 (8 497 units), the growth rate in terms of the *net creation* of units was over 57% at +976 units for 2006 compared with +621 units for the previous year.

The year 2007 looks promising so far, buoyed up by the excellent results recorded in 2006. During the first six months of the year, 229 new legal entities were launched (an increase of 68.4% over the same period last year). Meanwhile the net increase in fund units was 569 compared to 412 in 2006, an increase of 38.1% year on year. As at 30 June 2007, investors had 10,042 portfolios at their disposal.

All these elements confirm the continuing dynamic growth of the Luxembourg fund centre, registering an average of almost 9 new funds / 22 net new portfolios per week between June 2006 and June 2007.

3. Key Trends in flows and assets under management

End of period	Total assets under management (Eur bn)	Of which: UCITS nationally domiciled: Net assets (Eur bn)	Number	Average net assets by funds (Eur m)	Non-UCITS nationally domiciled: Net assets (Eur bn)	Number	Average net assets by funds (Eur m)
June 2006	1 652,12	1 500,43	7 525	199,39	151,69	1 384	109,60
Dec 2006	1 844,50	1 661,56	7 919	209,82	183,29	1 554	117,95
June 2007	2 047,02	1 839,13	8 307	221,40	207,89	1 735	119,82

NB: UCITS is used in the sense of publicly offered open-end funds investing in transferable securities and money market funds.
Data shown to two decimal places

Following record results in 2005, 2006 was once again an exceptional year for the Luxembourg investment fund industry. With an annual growth rate of nearly 21%, net assets in collective investment schemes reached 1,844.850 billion euros at 31 December 2006.

In terms of absolute growth, net assets under management grew by 319.62 billion during the period, corresponding to 76% of the net growth registered in 2005 which was the best year in the history of the industry. Equally, the figure is more than twice that of 2004 (net growth of 152.9 billion euros), another excellent year, and is nearly 30% more than the absolute record set in 1999, at the height of the stock market boom of the 1990s, when net assets rose by an exceptional 247.7 billion euros. In other words, 2006 is the second best year since 1999 in terms of absolute asset growth.

The large number of new fund (+345 funds) and sub-fund creations, the steady inflow of fresh capital from private and institutional investor and a particularly favourable stock market climate, particularly during the 2nd half of the year, explain the strong growth rate of 21% recorded in 2006.

This growth (+319.62 billion euros) can be attributed 75.5% to new capital inflows (241.34 billion euros), compared to 2005 when the impact of net sales represented only 56.4% of annual growth. Moreover, in absolute terms, net new sales surpassed the record year 2005, setting 2006 as a new record year in which the highest ever amount of capital was raised by the Luxembourg fund industry.

The remaining 24.5% can be attributed to market effect. Following excellent financial market performance in 2005, 2006 was more volatile. During the months of May and June a sharp correction in global stock markets caused a brief dip in assets under management. However, following a recovery during the second half of the year, stock markets contributed 78.3 billion euros to overall net asset growth.

This strong growth rate has continued into 2007, with an increase of 11% in the first six months of the year. Net assets managed by Luxembourg funds thus reached the extraordinary amount of 2,047.022 billion euros at the end of June 2007. Strong net subscriptions (+ 130.62 billions), combined with the positive impact of financial markets during this period (+71.55 billions), pushed net assets under management to exceed the two-billion mark.

Between 30 June 2006 and 30 June 2007 net assets under management grew by 23.9% or 394.90 billion euros. 55.3% of this increase can be attributed to net new investment by private and institutional investors. During the twelve months under review, these invested a net 218.40 billion euros into Luxembourg investment funds. Market performance (in what was a particularly bullish period) contributed some 176.50 billion euros to the growth of the sector.

In recent years, the average size of Luxembourg funds has increased steadily. Over the 12 months to June 2007, average net assets per fund unit rose by almost 10%, from 185.4 million euros to 203.8 millions.

	Total Assets under management (Eur bn)	**Of which:**				
		Fixed income	**Equity**	**Balanced**	**Money Market**	**Others**
End of period		Net assets (Eur bn)	Net assets (Eur bn)	Net assets (Eur bn)	Net assets (Eur bn)	Net assets (Eur bn)
June 2006	1 652,12	510,89	629,98	136,60	210,43	164,22
Dec 2006	1 844,85	534,60	738,32	171,01	216,55	184,38
June 2007	2 047,02	562,41	808,79	221,20	246,51	208,11

NB: Data shown to two decimal places

Net sales	**Of which:**

End of period	(1) Eur billions	UCITS				UCITS + NON-UCITS
		Fixed income	Equity	Balanced	Money Market	Others
June 2006	153,56	33,73	57,34	25,57	10,65	26,26
Dec 2006	241,34	84,09	40,32	47,64	16,87	52,43
June 2007	130,62	28,44	6,57	40,83	28,54	26,24

(1) cumulated net sales since the 1st January of each year
NB: Data shown to two decimal places

Following the re-classification of funds made by the CSSF in 2004, in the wake of the UCITS III Directive, certain money market instruments and other short term securities were integrated with the category “fixed income securities”. At June 2007 total assets held in this investment class were 797.43 billion euros as published by the CSSF. This explains why the assets held in “pure” fixed income funds in our table (above) is only 562.41 billion euros.

The same procedure was applied to equities, where UCIs investing in non-listed securities and venture capital were integrated in the CSSF statistics and show 812.24 billion euros instead of 808.79 billion euros in the table above.

The strong surge of new capital during the period under review did not really alter the landscape of the Luxembourg fund industry with regard to investment policy of UCITS & non-UCITS. The category "fixed interest securities” and the category "variable income securities" as considered by the CSSF together still comprise almost 80% of the market.

Within this total, however, the picture changed between June 2006 and June 2007. Equity funds, with 812.24 billion euros under management, became the largest investment class with 39.7% of the market, overtaking Fixed interest security funds which lost market share from 43.1% to 38.96% in June 2007. Meanwhile, mixed funds saw their market share rise from 8.3% to 10.86% over the period, with a total 222.24 billion euros under management.

4. Regulatory and self regulatory developments (including tax)

4.1. Capital Requirements Directive

The CRD was implemented via two circulars into the Luxembourg regulation for the financial sector. The circulars CSSF 06/273 and CSSF 07/290 have transposed the Directive for credit institutions and for investment companies. The circular on investment companies does as well apply to management companies subject to certain conditions which are detailed in the circular. The circular details as well the conditions for the application of the “expenditure based requirement”.
The circular was published in early 2007 and became immediately effective.

4.2. MiFID implementation

In March 2006 ALFI set up a working group to consider the significant issues for the fund industry raised by MiFID. The group aims to also identify opportunities for the Luxembourg fund sector created by MiFID. This work is being carried out in coordination with ABBL (the Luxembourg Bankers’ Association) which has also created two committees addressing the subject of MiFID. An impact analysis of the Directive was first issued by the working group in July 2006, after which the issues identified in that document were discussed with the competent authorities.

MiFID regulations have been transposed into Luxembourg law via the Law of 13th July 2007 and a Grand-Ducal decree of the same day relating to organizational requirements and rules of conduct in the financial sector as well as via the circulars 07/305 providing general information on the new law, 07/302 and 07/306 on transaction reporting and 07/307 on rules of conduct under MiFID.

More specific circulars will be issued by the CSSF in the near future as new Level 3 measures will be adopted at CESR level.

CESR has already published several consultation papers and guidelines with regard to such important topics as the treatment of inducements under the Directive and best execution rules. The ALFI working group drafted official responses to these documents and some of its members attended open hearings organized by CESR in relation to these issues.

Finally, representatives of the MiFID working group participated in various reflection groups on MiFID at both national and European level.

4.3. Specialised Investment Funds

The law on Specialised Investment Funds (SIF) that came into effect on 13 February 2007 replaced the law of 19 July 1991 on institutional investment funds that are not for sale to the public.

The 1991 law contained a number of cross-references to the now obsolete law of 30 March 1988 on undertakings for collective investment (UCITS I), rendering it necessary to replace the 1991 law: with effect from 13 February 2007, the 1988 law was replaced by the law of 20 December 2002 transposing UCITS III into Luxembourg law.

The Luxembourg legislator took advantage of the opportunity to create a legal framework that would encourage the development of investment funds targeting informed investors.

The new law broadens the definition of “eligible investor”, which is no longer limited to “institutional” investors, but includes any investor who has declared himself in writing to be an informed investor and who either invests a minimum of 125,000 euros in the special investment fund, or has been assessed by a credit institution, an investment firm or a UCITS III management company which certifies the investor’s ability to understand the risks associated with investing in the SIF.

Special Investment Funds may be set up in the form of a common investment fund (FCP-FIS), an open ended investment company (SICAV-FIS), or any other legal structure.

The law does not impose restrictions on the asset classes in which a SIF may invest. Hence this vehicle can be used to invest in transferable securities, money market instruments, real estate, commodities, financial derivative instruments, hedge funds and private equity.

The principle of risk spreading has been maintained, however the law does not lay down any quantitative restrictions in this respect.

Since SIF are reserved for sophisticated investors, the law submits them to a lighter regulatory regime than for funds that are distributed to the wider public. The supervisory authority has only to approve the custodian, the central administration and the “dirigeants” of the fund, and to satisfy itself that the fund’s constitutive documents are in compliance with the law. Hence, whereas the dirigeants of a SIF must be approved by the CSSF, the requirement for a fund promoter is abolished and the investment manager is no longer subject to scrutiny by the regulator. The SIF equally benefits from less onerous reporting requirements with regard to the provision of investor information.

4.4. Implementation of the ECJ decisions “BBL” and “Abbey National”

On 29 December, 2006 the Luxembourg VAT authority (“AED”) issued circular N° 723. This circular concerns the implementation of the European Court of Justice (ECJ) decisions of 21 October, 2004 in the case C-8/03 (BBL) and of 4 May, 2006 in the case C-169/04 (Abbey National). Further to these decisions, certain services rendered by depositary banks will be subject to VAT (Abbey National case) and investment funds will have to file VAT returns under certain circumstances (BBL case).
During the development period of this circular ALFI continuously informed the AED of its position. ALFI stressed that any new circular should ensure not only that implementation of the ECJ cases was EU law compliant but also that it did not impose unnecessary VAT burdens on the fund industry. The wording of the AED circular shows that this approach was adopted by the administration. ALFI is supporting its members with conferences, seminars and other publications on the subject to keep them informed and to ensure that the Luxembourg fund industry is in line with the new VAT requirements.

5. Investment management governance

Anti Money Laundering Guidelines

In consideration of various EU directives and Luxembourg laws and regulations, professionals in the investment fund industry believe that anti-money laundering regulation needs to be applied consistently throughout the industry in order to uphold the reputation of the financial centre and to avoid "regulatory arbitrage" and competition based on differing interpretations of AML regulation.

That is why ALFI, the Luxembourg Bankers' Association (ABBL) and the Association of Luxembourg Compliance Officers (ALCO) joined forces to work out a series of "Practices and Recommendations aimed at reducing the risk of money laundering and terrorist financing in the Luxembourg Fund Industry".

The document provides guidance on best practice for the Luxembourg fund industry in the light of the requirements of the law of 12 November 2004 on the fight against money laundering and terrorist financing and CSSF circular 05/211. It suggests a risk based approach in relation to customer identification and transaction monitoring in alignment with international standards, including the FATF recommendations, the European Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and the Wolfsberg Statement on "Anti-Money Laundering Guidance for Mutual Funds and Other Pooled Investment Vehicles". It provides a methodology for assessing the equivalence of legal and regulatory Know-Your-Customer requirements of foreign jurisdictions by comparing them to FATF standards. The extent to which actors in the fund industry follow the described practices and recommendations falls to the responsibility of their respective governance bodies.

The purpose of the document is furthermore to amend and replace the ABBL/ALFI "Practices and recommendations aimed at preventing the use of UCIs for money laundering" dated March 2000 and the ALCO document "Money laundering prevention in the framework of the transfer agent of a UCI administered in Luxembourg" dated May 2003.

The document is available on the ALFI website.

6. Product developments

Private Placement

See above "Specialized Investment Funds".

7. Other major issues and developments

<u>XBRL Luxembourg</u>

ALFI has thrown its weight behind the initiative to promote use in Luxembourg of the Extensible Business Reporting Language (XBRL), as an open technical standard for the definition and exchange of business and financial performance information.

This initiative should be seen in the context of the increasing need for supervision and control which mean that the transfer of financial data, statistics and other information between private enterprises and public institutions plays an ever more important role in the running of the economy.

Indeed, EU regulatory measures that do not contain a section entitled "information to be reported" are becoming rare. Hence the European Commission "Financial Services Action Plan" introduced the principle of harmonisation of certain reporting rules so that Community texts would be applied consistently in all 25 Member States.

In the area of financial reporting, the financial sector will thus be confronted in coming years with a series of changes which will fundamentally modify current practice.

In the majority of European countries, there is a clear trend towards the adoption of the XBRL standard for the exchange of data, based on the agreed definitions adopted in dictionaries called "taxonomies". A Taxonomy defines the information exchange requirements in a particular domain. Taxonomies can be set up for a wide range of applications including company reporting, consolidated accounts, tax declarations, reports, etc.
In order to take full advantage of XBRL, the organisations concerned must optimise its development and promote its adoption in Luxembourg. To this end, and in the light of the experience gained in other countries, nine institutions and associations of the financial centre have created the "XBRL Jurisdiction Luxembourg":

The Commission de Surveillance du Secteur Financier (CSSF)
The Banque Centrale du Luxembourg (BCL)
The Luxembourg Bankers' Association (ABBL)
The Association of the Luxembourg Fund Industry (ALFI)
The Luxembourg Association of Insurance Companies (ACA)
The Institut des Réviseurs d'Entreprises (IRE)
The Ordre des Experts Comptables (OEC)
The Service Central de la Statistique et des Etudes Economiques (STATEC)
The Luxembourg Stock Exchange (BdL)
The Commissariat aux Assurances (CAA or insurance regulator) has joined the Jurisdiction as a member.
The Jurisdiction gives Luxembourg access to the resources of XBRL International, which controls the maintenance and evolution of XBRL standards at a global level. Specifically, the Luxembourg community will be able to participate in the process of developing new opportunities, receive implementation support from XBRL International and have the chance to be in the vanguard of countries adopting products and services based on XBRL.
XBRL International defines an XBRL Jurisdiction as a non profit-making organisation representing a federation of interested parties in a given region, the object of which is to promote and guide the development and implementation of XBRL solutions adapted to the needs of its members. Any private or public organisation may be a member of the Jurisdiction. However, only the Jurisdiction itself can be a direct member of XBRL International, the underlying members becoming indirect members through their Jurisdiction.